Saskatchewan Financial Services Commission
Pensions Division

FUNDING DEFINED BENEFIT PENSION PLANS

Introduction

The process by which *The Pension Benefits Act, 1992* ensures the orderly funding of defined benefit plans is described in various sections of legislation, but can be summarized as follows:

1. the plan's actuary must review the plan's financial position and prepare an actuarial valuation describing the funding needs of the plan;

2. the employer is then responsible for remitting contributions on the basis of the valuation and in a manner required by legislation; and

3. the filing of an annual information return describing the funding that has occurred allows the Superintendent of Pensions to ensure that contributions are being made in accordance with the valuation.

This bulletin will attempt to explain the requirements of *The Pension Benefits Act, 1992* (referred to as "the Act") and *The Pension Benefits Regulations, 1993* ("the Regulations") with respect to each step in this process. As well, the bulletin will discuss some special issues surrounding funding. However, this bulletin has no legal authority. *The Pension Benefits Act, 1992* and *The Pension Benefits Regulations, 1993* should be used to determine specific requirements.

A "defined benefit provision" means a provision of a plan pursuant to which benefits are determined in any way other than solely by reference to what is provided by contributions made by or for the credit of a member together with interest. A "defined benefit plan" means a plan that contains a defined benefit provision. For simplicity, this bulletin will use the term "plan" rather than "defined benefit plan" or "defined benefit provision".

The Actuarial Valuation

1. Timing

In the case of a new plan, section 8 of the Regulations requires a plan administrator to have a plan reviewed as of the effective date of the plan. Thereafter, an actuarial review must occur at the end of a fiscal year and at intervals not exceeding three fiscal years after the preceding review date. As well, the Superintendent of Pensions has the authority to request a review be made of the plan at any time.

By review, we mean a review conducted by a Fellow of the Canadian Institute of Actuaries with respect to the financial position of the plan and the contributions required to be made to the plan to meet the tests of solvency required by legislation.

Having completed a review, clause 11(4)(b) of the Act requires the administrator to file with the superintendent an actuarial valuation report based on the review. In the case of a new plan, section 9 of the Regulations requires an actuarial valuation report to be filed not later than 120 days after the establishment of the plan. The plan is established on the date the persons authorized to establish the plan resolve to do so. The plan may have an effective date that precedes the date it is established.

In the case of a review occurring after the effective date of the plan, a valuation must be filed not later than 9 months after the review date. This filing deadline applies to all valuations that are filed with the superintendent, whether or not the valuation is due. The requirement is to conduct a review every third year. However, if a review is conducted one or two years after the preceding review date and the employer wishes to make contributions on the basis of the new review, then the actuarial valuation report resulting from the new review must be filed within 9 months of the review date.

2. Contents of the Actuarial Valuation

Section 10 of the Regulations requires an actuarial valuation to be prepared in a manner that is consistent with the Standard of Practice for the preparation of actuarial valuation reports issued by the Canadian Institute of Actuaries. The Institute's "Consolidated Standards of Practice – Practice-Specific Standards for Pension Plans" came into effect for valuations having an effective date on or after December 1, 2002. The previous standard, the "Standard of Practice for Valuation of Pension Plans" was in effect for valuations effective prior to that date, but subsequent to May 1, 1994.

Section 10 also describes the contents of an actuarial valuation report. A report must include the following so far as is applicable:

(a) the normal actuarial cost, showing separately the employer contributions and the member contributions relating to the normal actuarial cost:

  (i) for the fiscal year following the review date, where that date falls on the last day of a fiscal year; or

  (ii) for the fiscal year in which the review date falls, where that date falls on any other day;

(b) the rules for computing normal actuarial cost (i.e., percentage of payroll, cents per hour, dollar amount, etc.) and for allocating that cost between the employer and the members with respect to employment in the period covered by the report or certificate;

(c) the date of establishment and the unamortized balance of any unfunded liability, the special payments to be made to amortize that liability and the date at which that liability will be amortized;

(d) either:

(i) a statement that, in the opinion of the reviewer, there is no solvency deficiency; or

(ii) the date of establishment and the unamortized balance of any solvency deficiency, the special payments to be made to amortize that deficiency, and the value of the assets and liabilities used to determine that solvency deficiency, together with the assumptions and valuation methods used to calculate that deficiency and the date at which that deficiency will be amortized;

(e) either:

(i) a statement that in the opinion of the reviewer the solvency ratio is not less than 1; or

(ii) if the solvency ratio is less than 1, the solvency ratio, the value of the assets and liabilities used to determine the solvency ratio, and the assumptions and valuation methods used to calculate the liabilities;

(f) the surplus assets of the plan, and, if known to the reviewer, a description of how they will be utilized;

(g) the market value of the assets of the plan, and, if available, the book value of the assets of the plan and a description of the valuation method used to determine the going concern assets;

(h) the value of the going concern liabilities with respect to each of the following groups:

(i) members;

(ii) as a single group:

(A) former members who have not commenced to receive their pensions under the plan; and

(B) other persons who have a future entitlement to receive benefits from the plan; and

(iii) as a single group:

(A) former members who are receiving their pensions; and

(B) other persons who are receiving payments from the plan;

and a description of the assumptions and valuation methods used to determine those values; and

(i) in the case of a review occurring after the effective date of a plan, a reconciliation of the results of the review and identification of the gains and losses experienced since the date of the latest previous review.

3. The Prescribed Tests for Solvency

An actuary is required to provide opinions on the financial condition of the plan and on the contributions required to be made to the plan on the assumption: (1) that the plan will be a going concern and will not terminate and (2) that the plan has terminated at the review date. In support of his or her opinions, the actuary prepares a going concern valuation based on the first assumption and a solvency valuation based on the second.

A going concern valuation will be familiar to the users of actuarial valuations. The purpose of a going concern valuation is to recommend the orderly funding of a plan to accumulate assets to provide for the plan's benefits in advance of their actual payment. As previously mentioned, the actuary must make a recommendation with respect to the normal actuarial cost of the plan for the fiscal year following the review date. Legislation defines the normal actuarial cost of a plan as "the amount estimated ... to be the cost to persons required to contribute to the plan of the benefits of the plan for a fiscal year".

In addition to determining the plan's normal actuarial cost, the actuary must compare the plan's going concern assets to its going concern liabilities, as accrued to the date of the review. If the liabilities exceed the assets, then the plan is said to have an unfunded liability. An unfunded liability might exist because the plan's benefits were improved retrospectively without the plan having sufficient assets to provide for the benefit improvements. An unfunded liability also might be created if the assumptions on which the last valuation of the plan were based were not met.

Regardless of why an unfunded liability is established, the Regulations provide that an employer is obliged to make special payments to the plan sufficient to amortize the unfunded liability over a period not exceeding 15 years from the review date relating to the establishment of the unfunded liability.

In examining the solvency of a plan, the actuary must compare the plan's liabilities determined on a plan termination basis to the value of solvency assets. If a deficiency exists, then an employer is obliged to make special payments to the plan sufficient to amortize the solvency deficiency over a period not exceeding 5 years from the review date relating to the establishment of the solvency deficiency. These payments are in addition to contributions required with respect to the normal actuarial cost and to special payments with respect to unfunded liabilities.

In preparing a solvency valuation, all benefits which would be payable upon the termination of the plan must be included in the liabilities of the plan. The assumptions used to calculate liabilities are set as at the review date and not as at some later date, such as the report date. For instance, legislation provides that members not yet eligible to commence a pension be given the right to transfer the commuted value of benefits from the plan on plan termination. As such, the actuary would use the transfer value assumptions in accordance with the Recommendations for the Computation of Transfer Values from Registered Pension Plans to value benefits. The interest rate prescribed by those standards as at the date of the hypothetical termination would be used.

The actuary also must take into account the estimated expenses of administering the termination of the plan that would be required to be paid out of the pension fund.

For purposes of determining the value of a plan's assets when preparing a solvency valuation, the actuary must include:

(a) the market value of the assets of the plan as determined as of the latest review date or the value of plan assets related to their market value by means of an averaging method over a period of not more than five years; and

(b) any cash balances and accrued and receivable income; and

(c) the present value, determined in accordance with generally accepted actuarial principles using the same assumptions as are used in the solvency valuation of the plan's liabilities, of:

  (i) pre-1993 special payments;

  (ii) special payments payable with respect to benefits for employment before the effective date of the plan, if no benefits for that employment had been provided under the plan before the establishment of those special payments; and

  (iii) special payments payable over the five years following the plan's latest review date and not included in subclauses (i) and (ii).

Pre-1993 special payments are those which were established before January 1, 1993 pursuant to the former regulations.

Two final notes on the tests for solvency.

First, in a final or best average earnings type of plan, where the pension is based on a rate of salary at retirement date or on average rates of salary over a specified and limited period, a projection of the current salary of each member must be used to estimate the salary on which the pension payable at retirement date will be based when conducting a going concern valuation. A solvency valuation normally would not take into account a projection of salary.

Second, if the actuarial basis used in the actuarial valuation is such that an unfunded liability or solvency deficiency may not be revealed, as is the case with the Aggregate Method, then the actuary must perform supplementary calculations to show that the solvency tests are being met, and must certify to conducting those calculations and to the solvency tests being met.

Remitting Contributions

Section 40 of the Act requires that a plan be funded in accordance with a filed actuarial valuation report. An employer is required to make contributions that are sufficient to provide for all benefits in accordance with the prescribed tests for the solvency of the plan which were previously described. Employees contribute to a plan only if so required by the plan.

Section 36 of the Regulations requires contributions to be made monthly, both with respect to the normal actuarial cost and special payments. Section 37 of the Regulations requires the remittance of those contributions to the plan's fund holder within 30 days after the end of the month for which those contributions are payable.

That section also requires the remittance to the fund holder of any contributions made by the member within 30 days after the end of the month in which the contributions were received by the employer from a member or were deducted from the member's salary.

A fund holder is that person or entity which holds the pension fund of a pension plan. Section 41 of the Act describes who can act as a fund holder and includes an insurance company, a trust corporation and individual trustees. Except for multi-employer plans, the fund holder is obligated to inform the superintendent where an employer has failed to remit any required contributions.

To protect money which is payable, but not yet remitted to the fund holder, section 43 of the Act provides that money which has been received by an employer from an employee or has been withheld by an employer from money payable to an employee or is due to be paid by the employer as the employer's contribution is deemed to be held by the employer in trust. The employer cannot appropriate or convert any part of the money to the employer's own use or to any use not authorized by the terms of the plan.

The Annual Information Return

Clause 11(4)(a) of the Act requires the administrator of a plan to file an annual information return with the superintendent. The return is in a form established by the superintendent and must be filed within 180 days after the end of each fiscal year of a plan.

On the return, the administrator must report the amount of contributions actually paid to the plan with respect to the plan fiscal year under review.

Special Issues:

Plan Amendments

Section 8 of the Regulations provides that, where an amendment to a plan affects the cost of benefits provided by the plan, creates an unfunded liability or otherwise affects the solvency or funding of the plan, a re-evaluation of the plan's financial position is in order. The administrator may have the plan reviewed, in which case a comprehensive actuarial valuation must be prepared and filed. Alternatively, the administrator may have the latest review revised. If the latter approach is to be used, the plan's actuary must be confident that the data, assumptions and actuarial methods used in the previous review remain appropriate.

The administrator must file a new or revised actuarial valuation report within 120 days after the date the amendment is made. The date the amendment is made is the date on which the amendment is executed by whomever is authorized to amend the plan. The date the amendment is made is not necessarily the date that the amendment is effective - for instance, a plan's benefits could be improved retroactively. As well, the date the amendment is made is unlikely to be the date the amendment is registered with the superintendent. Registration typically occurs sometime after the amendment is made.

If a new review is conducted, the review date is deemed to be the last day of the fiscal year preceding the fiscal year in which the amendment was made, for purposes of the Regulations. This is particularly important with respect to the timing of the plan's next review.

Assume, for example, that a plan is amended by resolution of the Board of Directors of the company on October 4, 1994, the administrator is having a new actuarial valuation prepared and the fiscal year end of the plan is December 31. The administrator would be required to file the valuation with the superintendent within 120 days of October 4, 1994. For purposes of determining when the next review is due, the new review would be deemed to have occurred on December 31, 1993. The administrator would have the plan next reviewed no later than December 31, 1996, three years after the most recent review.

If the last review is revised, another actuarial valuation must be conducted within three years of the date of the last review. Suppose in the previous example that the administrator had chosen to revise the most recently filed valuation which was prepared as at December 31, 1992. The administrator still would be required to file the revision within 120 days of October 4, 1994, but the next review would have to be conducted no later than December 31, 1995.

Plan Terminations

Section 51 of the Pension Benefits Act, 1992 provides that the failure of an employer to make contributions is grounds for the superintendent to terminate the plan. As an exception to this rule, in certain cases an employer may use surplus assets to make contributions. As well, failure of an employer to make contributions pursuant to a multi-employer plan does not result in the termination of the whole plan.

Section 54 of *The Pension Benefits Act, 1992* describes the employer's obligations on the termination of the plan. Within 30 days after the termination of a plan, the employer:

"(a) shall pay into the plan all amounts whose payment is required by the terms of the plan or this Act; and

(b) without limiting the generality of clause (a), shall make all payments that, by the terms of the plan or this Act:

(i) are due from the employer to the plan but have not been made at the date of the termination; or

(ii) have accrued to that date but are not yet due."

Therefore, an employer is not obliged under legislation to make special payments with respect to an unfunded liability or solvency deficiency for the amortization period beyond the date of the termination.

Contribution Holidays

Contribution holidays are permitted under the Act. Subsection 51(4) of the Act allows an employer to use surplus assets to provide employer contributions, if:

1. the plan permits that use;

2. the intention of the employer to do so is disclosed to the members and former members in the manner described by section 41 of *The Pension Benefits Regulations, 1993*; and

3. the superintendent has approved that use of surplus assets.

In determining whether or not a plan permits the use of surplus assets to make employer contributions, the Pensions Division will be guided by the decision of the Supreme Court of Canada decision on Schmidt v. Air Products Canada Ltd. The Court's decision with respect to an employer's right to take a contribution holiday appeared to turn on this conclusion: "When permission is not explicitly given in the plan, it may be implied from the wording of the employer's contribution obligation. Any provision which places the responsibility for the calculation of the amount needed to fund promised benefits in the hands of an actuary should be taken to incorporate accepted actuarial practice as to how that calculation will be made. That practice currently includes the application of calculated surplus funds to the determination of overall current service cost."

Clause 36(3)(a) of the Regulations requires an employer to pay into a plan the normal actuarial cost allocated to the employer "as stated in the most recent actuarial valuation report or cost certificate filed". Therefore, an employer's obligation with respect to the payment of the normal actuarial cost cannot change until another actuarial valuation report or cost certificate is filed. As a result, a contribution holiday only can occur prospectively from the filing of an actuarial valuation that supports the use of surplus in this way and cannot occur retroactively to the date of the review. If the plan has sufficient surplus assets, a contribution holiday could continue until the next actuarial valuation is filed.

More on Special Payments

The need to make special payments to fund unfunded liabilities and solvency deficiencies was discussed earlier. Section 36 of the Regulations provides guidance in their payment:

- Special payments must be made at least monthly in equal amounts that are sufficient to amortize the unfunded liability or solvency deficiency over a period not exceeding 15 years and 5 years, respectively, from the review date relating to the establishment of the unfunded liability or solvency deficiency (not the date the actuarial valuation is filed).

Alternatively, the employer may make at least monthly payments expressed in a manner that each payment is a constant percentage of future payroll of the members, projected as of the date of the original establishment of the unfunded liability or solvency deficiency, provided that the actuarial present value of all such payments is equal to the unfunded liability or solvency deficiency. If salaries are projected to rise, this would result in a schedule of special payments which increase over time, rather than as a schedule of equal payments.

- Each unfunded liability or solvency deficiency must be funded and reported separately. As noted earlier, the present value of some future special payments with respect to unfunded liabilities may be taken into account as a plan asset for purposes of determining whether the plan has a solvency deficiency. Those special payments must continue to be made even if special payments with respect to a solvency deficiency also are required.

- Where a solvency deficiency has been amortized, the plan's actuary may recalculate any special payments with respect to any unfunded liability that has not been amortized.

- If the valuation reveals that a plan has surplus assets, the surplus assets must be used to reduce the outstanding balance of any unfunded liability, with the oldest established unfunded liabilities being amortized or reduced before later ones. As well, further special payments may be reduced on a prorated basis over the remainder of the unamortized period.

- At any time, an employer may increase the rate of amortization of an unfunded liability or solvency deficiency by increasing the amount of the special payments, making special payments in advance or making additional payments of any kind. Where the rate of amortization is increased, the amount of a special payment in a fiscal year subsequent to the year in which the additional amount is paid may be reduced to take into account the reduction in the amortization of the unfunded liability or solvency deficiency.

- Where special payments arise as a result of a plan amendment, the 15 and 5 year periods are treated as commencing from the date the amendment is made, not the review date.

Defined Contribution Plans Underwriting Annuities

A plan that is purely defined contribution is not required to file an actuarial valuation and fund on the basis of the valuation as described in this bulletin. However, we are aware of some defined contribution plans that underwrite annuities for its members. In lieu of transferring money to an insurance company to purchase a life annuity, a member may purchase a life annuity from the plan itself.

For the purposes of the Act and Regulations, the annuity underwriting operation of such plans is considered to be a defined benefit provision. This means that the requirements of legislation described in this bulletin must be followed.

Negotiated Cost Defined Benefit Plans

The Act and Regulations operate to establish funding obligations for an employer. The employer must make contributions equal to the normal actuarial cost of the plan, unless the plan provides for employee contributions. The employer must make special payments with respect to an unfunded liability or solvency deficiency. Generally speaking, these obligations are without limit.

However, subsections 40(5) and (6) of the Act deal with a special arrangement known as a negotiated cost defined benefit plan. An employer's liability with respect to the funding of a plan may be limited to the amount that is provided for in the plan where the liability of the employer is limited pursuant to a collective bargaining agreement.

Where the employer's liability is so limited, the plan must provide for the reduction of benefits to ensure that the plan meets the prescribed test for solvency, subject to the approval of the reduction by the superintendent.

Solvency Deficiency v. Solvency Ratio

The solvency deficiency was described earlier under the heading "The Prescribed Tests for Solvency". A solvency deficiency exists if the liabilities of a plan, determined on a plan termination basis, exceed the market value of its assets, together with the present value of certain future special payments. If a solvency deficiency exists, special payments are required to be made to the plan.

A plan's solvency ratio is the fraction obtained by dividing the market value of the assets currently held in the plan (plus any cash balances and accrued and receivable income) by the liabilities of the plan on a plan termination basis. In other words the present value of certain future special payments is excluded from the determination of the value of assets. If a plan's solvency ratio is less than one, then the plan administrator may have to withhold for a period of time a portion of the commuted value of benefits that are being transferred from the plan. Section 28 of the Regulations addresses such transfer issues.

As well, if a plan's solvency ratio is less than one, section 13 of the Regulations requires the plan administrator to include on the annual statement to plan members a statement that the plan's assets are not sufficient to cover the liabilities accrued with respect to benefits promised, as at the latest review date, and that special payments are being made to make the plan solvent in accordance with pension legislation.

Cost Certificate v. Actuarial Valuation

Subsection 11(4) of the Act provides that a plan that contains a defined benefit provision must file an actuarial valuation report and a cost certificate. Subsection 11(6) states that an actuarial valuation report need not be filed if filing a cost certificate is sufficient to enable the superintendent to determine whether the plan will meet the solvency tests.

This bulletin has discussed at length the content of an actuarial valuation report. Generally speaking, a cost certificate is a summary of the actuarial valuation report. It indicates the financial position of the plan, the funding recommendations and a summary of key assumptions. It also contains a certification section that the actuary must complete.

The Act requires the cost certificate to be in a form required by the superintendent. Although we have developed a cost certificate, it has not been issued. It is our understanding that in the process of developing a consolidated standards of practice, the Canadian Institute of Actuaries will be recommending a standard report format. We prefer to make use of the Institute's standards whenever possible. Accordingly, the superintendent will not be issuing a cost certificate form pending the outcome of the Institute's work. For the moment, plan administrators are required to file an actuarial valuation report. That report may or may not include a cost certificate of the actuary's own making.

Prosecution

Section 70 of *The Pension Benefits Act, 1992* states that it is an offence for an employer to fail to remit all amounts that the employer is liable to remit. An employer is liable on summary conviction to a fine not exceeding $100,000. In addition, the court shall order the employer to pay all amounts that the employer is found liable to remit to the plan.

Where a corporation is guilty of an offence against the Act, an officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence and is liable on summary conviction to a fine not exceeding $100,000, whether or not the corporation has been prosecuted or convicted for the offence.

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Prepared: December 2002